

Australia & New Zealand Economics Weekly

Updating the Australian GDP and CPI Outlook

- **Lower AUD takes over the rebalancing challenge.** The sharp fall in the AUD this week should boost the prospects for rebalancing of the Australian economy and help cushion the economy from the slowdown in China and other emerging economies. We expect growth to remain moderately below trend for most of this year but for a return to trend growth of around 3% next year.
- **Underlying inflation to remain favourable to the RBA.** Our new inflation forecasts show price pressure remaining benign, affording the RBA the option of cutting rates further should the economy require it.
- **Next week in Australia**, there's the May Private Sector Credit (f/c 0.3%). **In New Zealand**, data include May Trade Balance (last \$NZ157m) and May YTD Industrial Production (last 11.4% YoY). **In the US**, data include May Durable Goods Orders (last 3.5%), May New Home Sales (last 454K), Q1 GDP (Prelim 2.4%) and 1Q Chain Price Index (Prelim 1.1%) as well as May Personal Income (last 0.0%). Later in the week, there's June Chicago Barometer (last 58.7) and June UoM Sentiment (Prelim 82.7). **In China**, there's the June Manufacturing PMI (f/c 50.1).

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With thanks to

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Figure 1. Key economic and financial forecasts

Indicator	Latest	2013	2014	Forecasts	Spot	Sep 13	Mar 14
Australia				Australia			
GDP	2.5%	2.6	3.1	Cash	2.75	2.75	2.75
CAD/% GDP	-2.3%	-2.8	-3.6	90 Day Bills	2.81	2.95	3.20
CPI-end	2.2%	2.1	2.8	3 yr Bonds	2.79	2.70	2.90
Profits	-2.2%	0.8	5.5	10 Yr Bonds	3.71	3.50	3.70
Unemp Rate (end)	5.5%	5.9	5.7	AU/US Spread	+127bp	+110bp	+90bp
				\$A/\$US	0.96	0.97	0.96
				ASX 200	4700		
New Zealand				New Zealand			
GDP	2.4%	2.6	2.8	OCR	2.50	2.50	2.75
CAD/% GDP	-4.8%	-5.5	-6.8	90 Day Bills	2.65	2.70	3.00
CPI-end	0.9%	2.0	2.2	2 year bonds	2.85	2.60	2.95
Unemp. Rate (end)	6.2%	6.1	5.1	10 year bonds	4.10	3.50	3.90
				NZ/US spread	+166bp	+110bp	+110bp
				NZ/AU Spread	+39bp	+0bp	+20bp
				\$NZ/\$US	0.78	0.80	0.80
				NZX 50	4439		

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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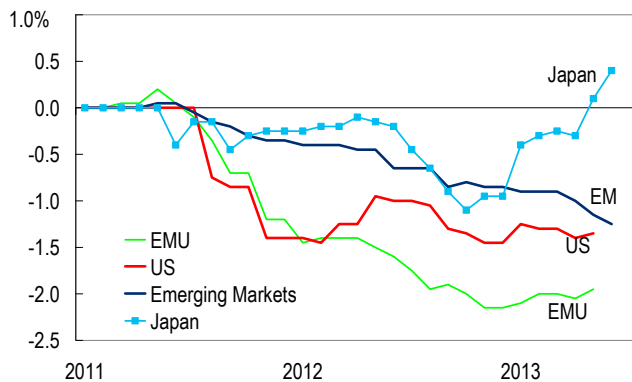
Australia: Updating the Outlook

Global backdrop

Our global growth forecasts are little changed, at 2.6% for 2013, 3.2% for 2014 and 3.4% for 2015 (versus 2.6%, 3.2% and 3.6% respectively last month). World trade growth remains sluggish, the euro area remains in recession and growth is weakening in a range of emerging markets. As in recent months, we are once again cutting our growth forecasts for a range of emerging market countries, including China, and lifting growth forecasts overall for advanced economies (notably Japan and the UK). Overall, our growth forecasts remain a little below consensus, especially for the euro area, China and India (Figure 3).

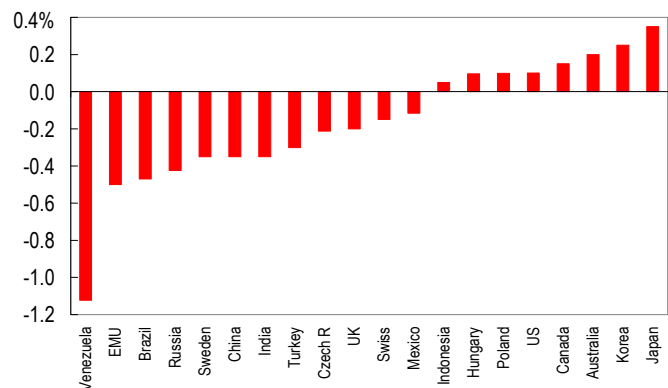
The combination of this week's FOMC statement, the Chairman's remarks and updated economic projections today was mostly in line with our expectations. If economic conditions play out as expected, officials are ready to move forward with tapering asset purchases, probably starting at the mid September FOMC meeting. But they have not backed away from recent guidance that rate hikes are still well off in 2015. As such, monetary policy will remain highly accommodative for the next year even as the recovery builds momentum. This combination ultimately should be supportive of risk assets provided bond yields do not sell off aggressively.

Figure 2. Global — Cumulative Changes in Citi Forecasts for GDP Growth in 2013-14 Since January 2011, 2011-13



Note: We show the average for forecasts in 2013-14. Source: Citi Research

Figure 3. Selected Countries — Citi Forecasts for GDP Growth in 2013-14 Versus Consensus



Note: We show the average for forecasts in 2013-14. A positive figure implies the Citi forecast is above consensus. Sources: Consensus Economics and Citi Research

The multi-year period of emerging market outperformance and resilient balance sheets is now giving way to growth downgrades with rising imbalances — worsening current accounts and rising private debt/GDP ratios. We believe that China's policymakers now regard a further modest economic slowdown to 7%-7½% real GDP growth as less disruptive than a colossal new credit stimulus aimed at restoring growth to 8%+. China's private debt/GDP ratio already has soared by about 50 percentage points in the last four years, a markedly bigger rise than those in the US and euro area over the six year period of 2002-08. Excluding China and the Middle East, the remaining EM countries will have an aggregate current account deficit of 1½%-2% of GDP this year, the highest since the late 1990s. Many EM countries now face the long-absent challenge of having to attract capital with worsening fundamentals at a time when (with the prospect of Fed tapering) global liquidity conditions may not be improving further. Please see [Global Economic Outlook and Strategy - June 2013*](#) for more information.

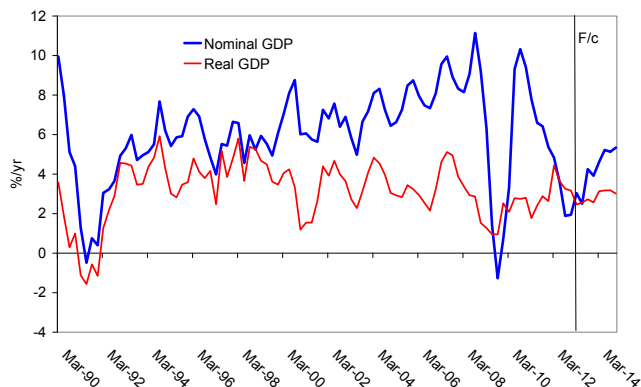
More positively, in Japan, we now assume that the government will deliver another large fiscal stimulus package to mitigate initial negative impacts from the consumption tax hike slated in April 2014. As a result, we are lifting our growth forecasts to 2.2% this year and 1.9% in 2014, up by 0.2% and 0.4% respectively from last month. Nevertheless, we still doubt that Japan is yet on a path to achieve 2% inflation on a sustained basis.

For Australia, the global forecasts imply continued moderate downward pressure on commodity prices and the AUD. The rise in the terms of trade in Q1 was probably only temporary and we expect renewed moderate declines in the terms of trade given our economists' forecasts for slower growth in Chinese industrial production and emerging economies more broadly. Continued strength in the USD as the Fed tapers QE should keep downward pressure on the AUD, as would a lesser investment appetite towards EM economies.

Domestic economic outlook slightly softer in near term

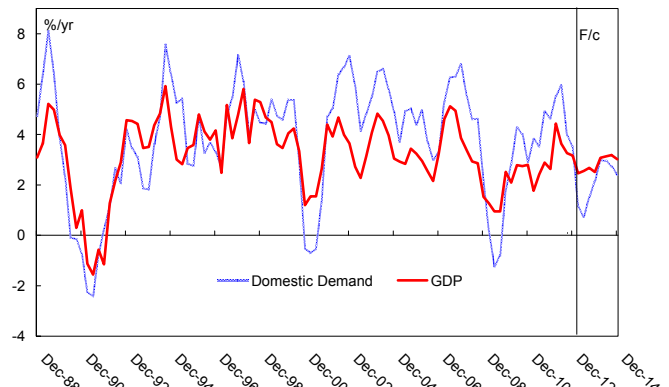
The domestic outlook hasn't changed significantly. We have slightly shaved our 2013 economic growth forecast to 2.6% but left our 2014 forecast unchanged at 3.1%. Both forecasts are a little above consensus (Figure 3). Growth this year is expected to be moderately below trend (Figure 4 and Figure 5), resulting in a gradual rise in the unemployment rate to a touch below 6%. The slowdown mainly reflects a weaker outlook for investment as the lower terms of trade winds down the contribution to growth from mining capex.

Figure 4. Real and nominal GDP growth



Source: ABS & Citi Research

Figure 5. Domestic demand and economic growth



Source: ABS & Citi Research

Next year we expect economic growth to return to around trend. The rebalancing of the economy should start to take more shape, led by housing investment and consumer spending, and mining capex should remain at relatively high levels even if it is no longer adding to growth. Nominal GDP growth should also pick up assuming smaller declines in commodity prices and some pick up in inflation.

Market pricing anticipates more rate cuts to achieve this rebalancing. But with the AUD now having fallen significantly to closer to US 90 cents and the TWI down over 10% from its peak, we believe the RBA is more likely to leave the cash rate unchanged. That said, if inflation continues to surprise to the downside or China's growth weakens sharply, another rate cut would be more likely.

- **On the positives.** Real GDP growth in Q1 was broadly in line with our expectation and nominal GDP growth picked up as profits rebounded. Export growth has been stronger than expected, the housing recovery is getting more traction, the AUD has fallen, inflation is lower than expected, the unemployment rate remains steady and consumers have built a financial war chest with the saving ratio continuing to sit above 10%.
- **Less positively.** Business conditions and confidence remain weak, mining investment is peaking and non-mining business investment remains weak. There has been no real pick up in the appetite for credit. Elections are usually associated with somewhat lower spending.

Figure 6. Key Australian economic forecasts

	2011	2012	2013F	2014F
Real GDP	2.4	3.6	2.6	3.1
Nominal GDP	6.0	3.0	3.4	5.1
Consumer	3.4	3.3	2.4	3.1
Housing	0.7	-3.8	3.9	5.7
Business investment	17.3	15.9	0.6	1.7
Trade contribution	-2.2	-0.1	1.8	0.5
Inflation (at end year)	3.0	2.2	2.1	2.8
Underlying CPI, end year	2.9	2.4	1.9	2.4
House prices	-2.6	-0.7	2.9	4.1
Profits	6.6	-4.5	0.8	5.5
CAD % of GDP	-2.3	-3.7	-2.8	-3.6
Terms of trade	12.8	-10.4	-5.0	-4.2
Unemployment rate (end)	5.2	5.3	5.9	5.7
Cash rate (at end year)	4.25	3.00	2.75	3.75

Source: ABS, RBA & Citi Research

Risks still related to rebalancing and low business confidence

The transition in Australia's growth drivers remains uncertain. If mining capex drops off rapidly, say because of uncertainty over future commodity demand associated with a sharper slowdown in China if the current funding squeeze on Chinese banks worsens, it would be less likely that other areas of spending could fill the gap quickly enough to prevent economic growth dropping sharply and unemployment blowing out. In that world the RBA could cut rates to below 2%.

More positively, there are upside risks if confidence improves. Fundamentals are reasonably constructive, particularly relative to most global peers. The high AUD has been one of two factors highlighted by businesses as holding back confidence. A second factor has been concerns about the political backdrop. Businesses have expressed concerns about the lack of policy certainty and a possible sharp tightening of fiscal policy after the election. If these concerns could be resolved well before year end, growth could be stronger than expected next year.

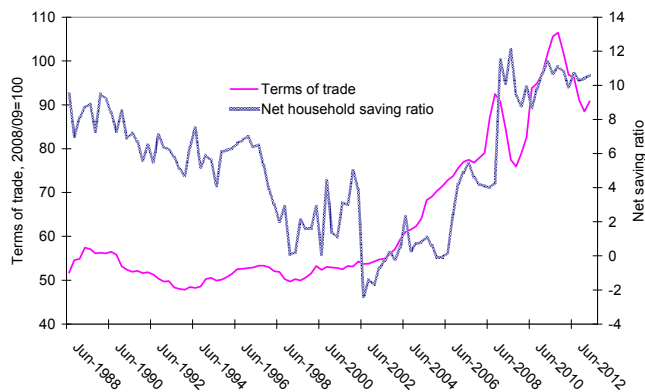
Consumer remain somewhat cautious

Our consumer spending forecasts are slightly lower. Until employment growth picks up it is likely that consumer spending will remain subdued. As a result, growth in consumer spending this year is looking like it could be around 2½%, a little less than we had been previously expecting. Spending has been growing in line with the slow growth in disposable income and so far consumers haven't been prepared to dip into saving, which is running at above 10% (Figure 7). However, wealth has been rising strongly and confidence is sitting at levels which are consistent with a

moderate pick up in spending. Consequently, if unemployment peaks later this year at a touch under 6%, consumer spending growth could pick up to 3% next year (Figure 8).

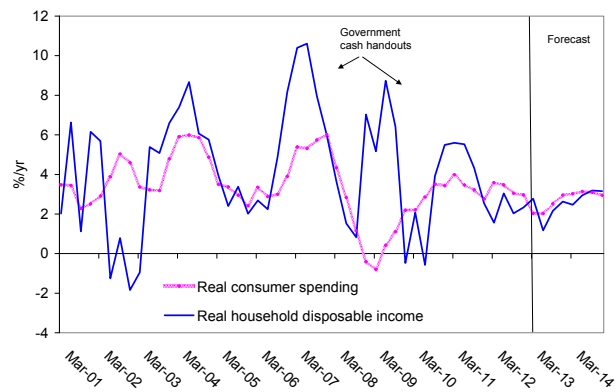
We have raised our forecast for the unemployment rate. The unemployment rate has been broadly steady now since September last year at around 5½% with more of the pain from cost cutting falling on hours worked than employment. But with ongoing restructuring by companies to lift productivity the unemployment rate will likely drift higher to closer to 6% before it peaks and then improves.

Figure 7. Household saving and terms of trade



Source: ABS & Citi Research

Figure 8. Household income and consumption



Source: ABS & Citi Research

Housing: mild recovery still expected

We continue to expect a mild recovery in housing activity over the next 18 months.

- RBA rate cuts and slightly lower house prices over the past few years have improved affordability and households are saying it is a good time to buy a dwelling.
- New dwelling investment rose for the third successive quarter in Q1 and building approvals and housing finance are inching higher. Spending on alterations and additions has been surprisingly weak but normally increases as new construction picks up so we expect a pick up in H2 this year.
- The tight rental market has seen rises in yields, while funding costs have fallen. This is encouraging investor interest.

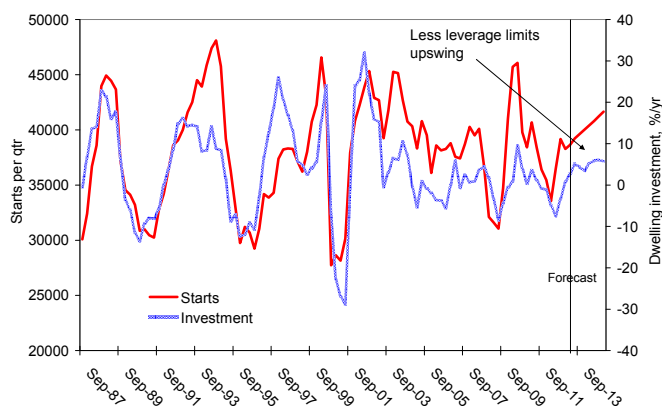
Nevertheless, there remain significant headwinds to the new construction and renovations outlook.

- The subdued appetite for debt.
- Constraints on expanding housing supply and cash flow pressures on developers and builders.
- Less favourable demographics.

Both our 2013 and 2014 housing investment forecasts are little changed. This is for dwelling investment to rise 4% in 2013 and 5¼% in 2014. So far starts have risen by around 14% from their lows and we expect a further rise of around 10% over the next two years. This would take starts to a touch under 165K in 2014, still well below previous peak levels (Figure 9).

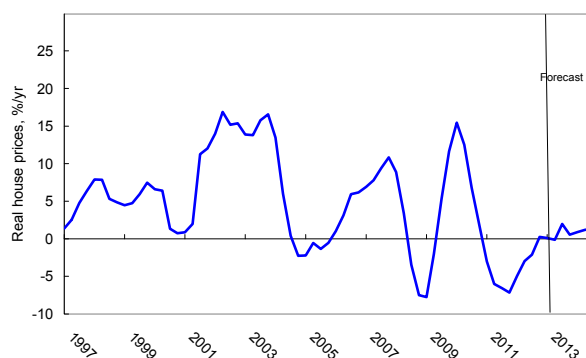
Signs of improvement in the property market but prices more stable. Auction clearance rates have been around 70% in both Sydney and Melbourne and house prices are moderately above their lows. There is no real change to our forecast for house prices in 2013 (i.e. down slightly in real terms), with a slight rise in real terms in 2014 (Figure 10). Unless leverage takes off it is hard to see large house price rises. We expect pressure on rents to continue given the low level of new construction.

Figure 9. Housing starts and investment outlook



Source: ABS & Citi Research

Figure 10. House price outlook



Source: ABS & Citi Research

Business capex outlook weaker

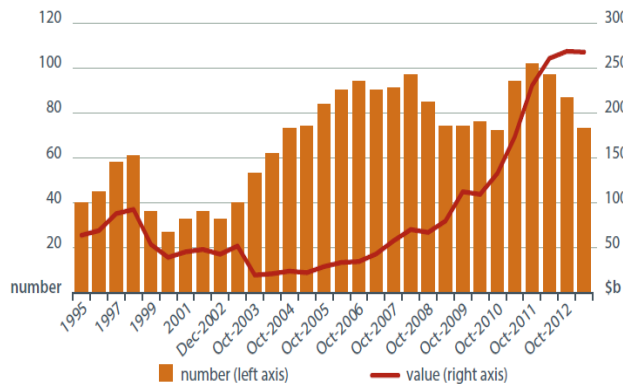
Business investment is expected to provide no contribution to economic growth in either this year or next. This represents a mild downgrade from our previous forecasts and a sharp turnaround from the contribution of 2½% of GDP last year.

The correction in mining capex is already underway. Mining investment was basically flat in H2 last year and fell in Q1. Company expectations point to some growth in FY14, but the pipeline of committed resource projects has fallen (Figure 11) as companies focus on trimming costs against a backdrop of slower growth in Asia and continuing recession in Europe.

Prospects for non-residential building remain subdued. This reflects the low level of business confidence and slow growth in household demand. Manufacturing investment is particularly weak. It will take time for the lower AUD to filter into investment decisions.

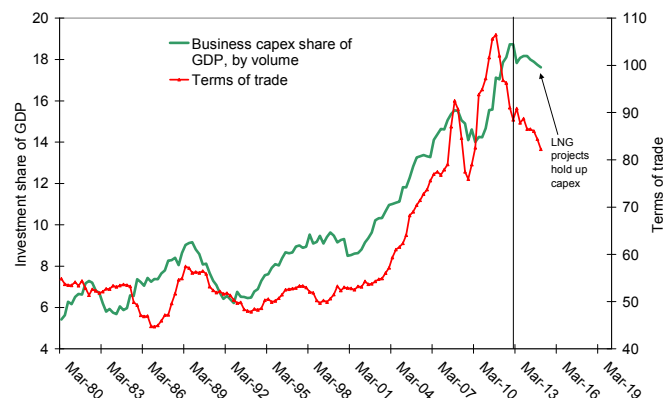
The risks to our forecasts are probably to the downside. Ahead of the federal election and given companies' focus on cost cutting and capital management, investment could be weaker than expected until the benefits of the lower AUD kick in. Thereafter, investment could rebound more strongly.

Figure 11. Committed resource investment projects



Source: BREE

Figure 12. Terms of trade and business investment



Source: ABS & Citi Research

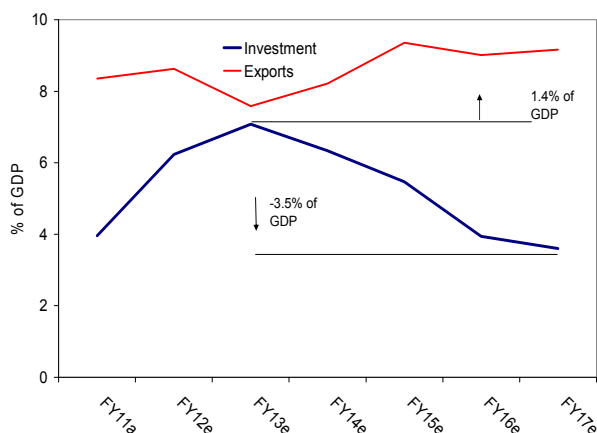
Exports support the outlook

Talk about the risk of recession ignores the bright prospects for mining exports. We have upgraded our 2013 forecast for export volumes and left our 2014 forecast of strong growth broadly unchanged.

The growth in export volumes should remain strong as more mining projects shift into the production phase. This is the flipside of the phasing down of mining investment and at least partly fills the gap left by lower investment. Over the next few years mining investment could fall by 3%-4% of GDP, with exports partially offsetting this by around 1½% of GDP (Figure 13). Lesser imports associated with lower mining capex (Figure 14) and the lower AUD should also partly fill the growth gap.

As a result, we expect the current account deficit to remain relatively low and below our previous forecasts. Even allowing for further falls in commodity prices and higher import prices, the positive contribution from net export volumes should keep the current account deficit below 4% of GDP.

Figure 13. LNG, iron ore & coal investment and exports



Source: BREE & Citi Research

Figure 14. Imports and business investment growth



Source: ABS & Citi Research

Fiscal policy mixed for the economy

The federal Budget was broadly neutral for the economy. The budget deficit is projected to fall only slightly in FY14 (Figure 15) and new measures announced in the Budget mainly impact the economy in later years.

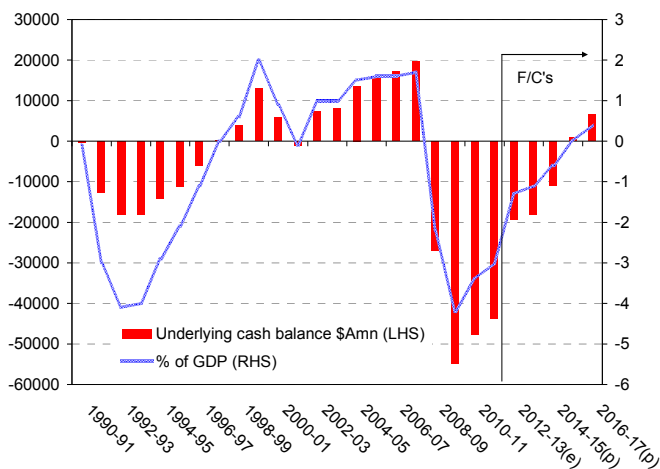
We doubt a Coalition government would tighten fiscal policy aggressively.

While the Coalition have said they would cut the public service and review spending and taxation, their rhetoric about how quickly they would return the budget to surplus has softened in our view. They have promised to maintain benefits to households associated with the carbon tax even though they would seek to repeal the tax. One risk for companies is that the Coalition is proposing to raise the tax rate on large companies to pay for an upgraded parental leave scheme.

More positively, there is an increased willingness by governments to review infrastructure requirements, most notably by the NSW government.

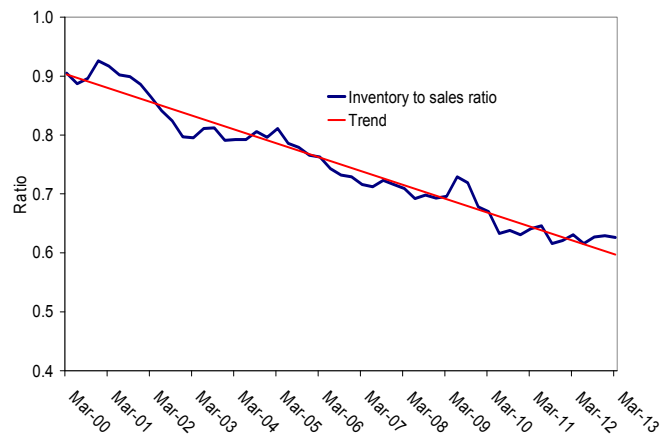
Realistically though, the majority of touted road and rail projects are unlikely to contribute materially to economic growth until 2015 and beyond given long lead times and the need to sell assets to help fund the investment.

Figure 15. Budget position and forecasts



Source: 2012 MYEFO & Citi Research

Figure 16. Inventory cycle



Source: ABS & Citi Research

Inventory cycle looks heavy

Further inventory correction is possible in the short term. Despite inventories correcting in Q1, they still look high relative to sales (Figure 16), so unless sales pick up inventories could remain a drag on the economy.

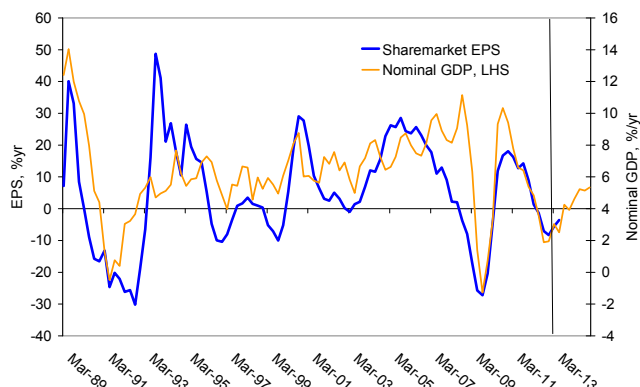
Implications for company profits

The profit outlook has turned. Our economic forecasts are consistent with signs that the downward momentum of share market EPS has come to an end (Figure 17 and Figure 18). The negative drags from the high AUD and weak demand have maxed out and productivity growth has accelerated as firms cut costs.

Analysts expect a healthy earnings rebound in FY14 of a touch above 10%.

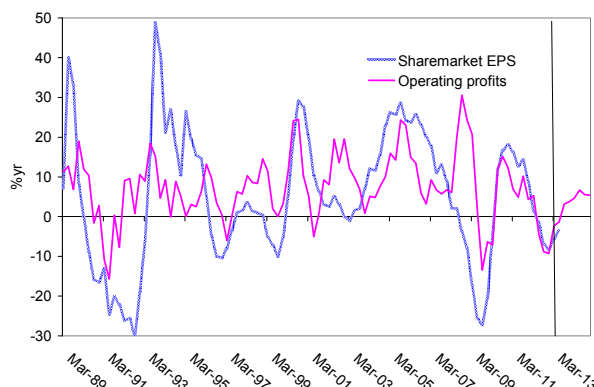
This is more aggressive than our economic forecasts imply (more like high single digits), partly because the EPS estimates incorporate increased offshore earnings from the lower AUD. These earnings aren't included in our measures of domestic generated profits. Our strategists' are constructive on the market and have an end year target for the ASX200 is 5400.

Figure 17. Nominal GDP growth and share market earnings



Source: ABS, IBESS & Citi Research

Figure 18. Non-financial company profits and share market earnings

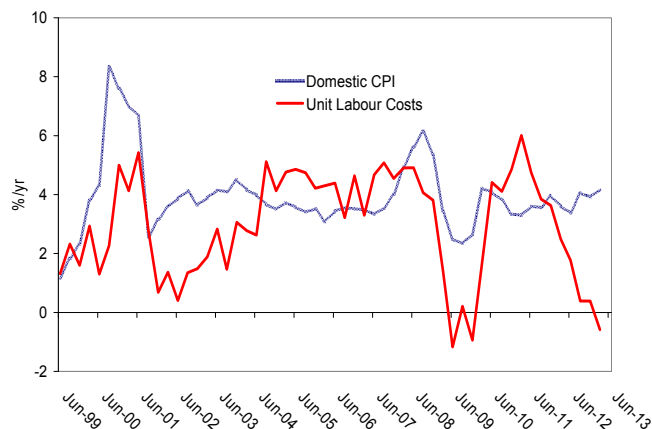


Source: ABS, IBESS & Citi Research

Inflation Outlook

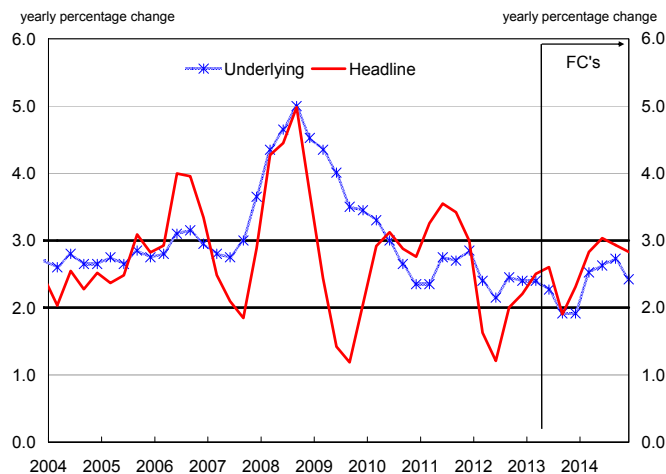
The inflation outlook should remain sustainable from the RBA's perspective. With little change in our aggregate economic forecasts that continues the theme of below trend growth this year before a growth profile closer to trend next year, inflation is likely to remain within the RBA's target band (Figure 20).

Figure 19. Unit labour costs and inflation



Source: ABS & Citi Research

Figure 20. Inflation outlook



Source: ABS & Citi Research

Within the broad forecast profile, yearly headline inflation is forecast to be 0.4 of a percentage point lower in 2013 than our previous forecasts. Slower growth in unit labour costs and a slightly wider output gap create fewer opportunities for domestic inflation worries. Our year average forecast for 2013 is 2.3%. At the margin, we view the risks being to the upside. The decline in the currency is likely to see imported inflation strengthen. We don't expect this to be a major influence on overall inflation because there is little opportunity for pass-through of higher prices in an environment of sub trend economic growth and demand elasticity.

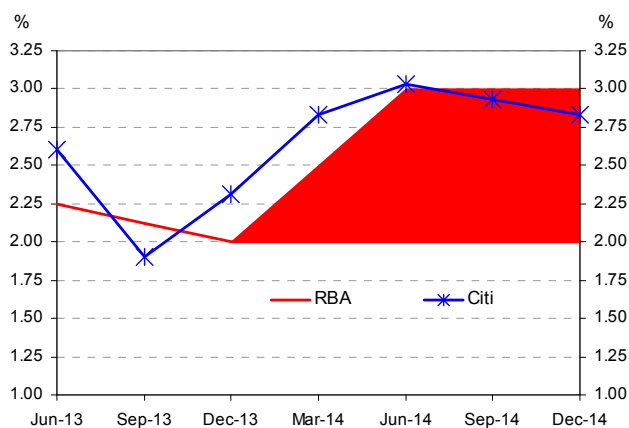
Yearly headline inflation is expected to pick-up by more in 2014, averaging 2.9%. Closure of the output gap, a pick-up in labour costs followed by some house price appreciation and price pass through from businesses produces a mid year peak of 3.0% before a small moderation. To be fair, some of the yearly increase reflects the base level for the calculation reflecting a period of very benign inflation at the end of 2013/start of 2013. Note that none of the quarterly inflation forecasts represent overly large price increases like those that partly occurred from large increases in regulated prices like utilities or the introduction of the carbon tax in Q3 2012.

We expect to see yearly underlying inflation remain in the lower half of the RBA's target band, on average, over the next two years. The forecast profile is similar to our previous forecasts in that low quarterly results in 2013 will help keep yearly underlying inflation anchored around 2.0%. This will afford the RBA the ability to lower the cash rate target further should the economy require more policy stimulus. In 2014, yearly underlying inflation is forecast to move to the middle of the target band.

We see the risks to the underlying forecast profile as fairly even in 2013 but slightly higher in 2014. This reflects the dual nature of the macroeconomic risks facing Australia this year, but the potential for trend growth to lift the net balance of CPI basket items higher next year. An environment of trend growth is also more likely to see some businesses attempt to pass on more price rises in an effort to lift profitability.

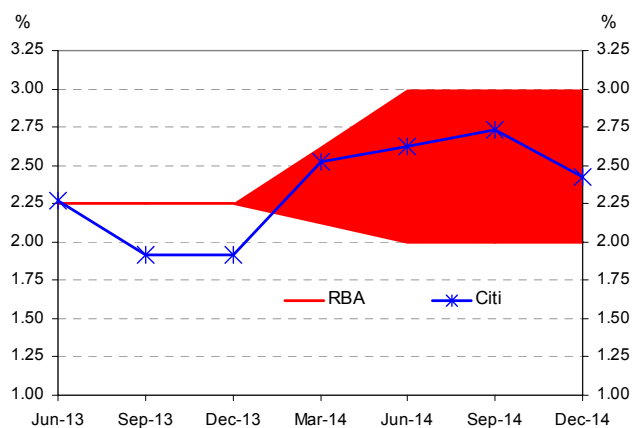
A comparison of our forecasts to the RBA's inflation outlook. Overall, our CPI forecasts show an earlier pick-up in headline inflation and a lower path for underlying inflation for the period where the RBA provides point forecasts (Figure 21 and Figure 22). Beyond that point, our forecasts are within the interval estimates provided by the RBA.

Figure 21. Headline yearly inflation forecasts



Source: RBA & Citi Research

Figure 22. Underlying yearly inflation forecasts



Source: RBA & Citi Research

Full details of the economic forecasts are in Figure 23 over.

Figure 23. Australian economic forecasts and changes (%)

	Fiscal years					Calendar years						
	2011/12	2012/13F	Diff*	2013/14F	Diff*	2011	2012	Diff*	2013F	Diff*	2014	Diff*
Output & Demand:												
GDP Year Average	3.4	2.9	0.0	2.9	-0.1	2.4	3.6	0.0	2.6	-0.2	3.1	0.0
GDP Adjusted for Terms of Trade	3.5	0.5	0.0	2.5	0.3	4.9	1.3	0.0	1.7	0.1	2.3	0.1
GDP 12 months to end year	3.6	2.6	-0.1	3.2	0.1	2.6	3.3	0.1	2.6	-0.2	3.0	0.0
Primary	6.1	5.4	-0.1	5.4	0.2	1.2	6.7	-0.1	5.4	0.3	5.6	0.0
Industry/Cyclicals	1.7	0.7	-2.0	1.7	-1.0	1.9	1.1	-0.5	0.5	-2.7	2.5	0.1
Services	3.5	3.1	0.7	2.8	0.2	2.8	3.9	0.3	2.8	0.6	2.8	0.0
Domestic demand	5.3	2.3	-0.3	2.4	-0.3	4.2	4.7	0.1	1.4	-0.6	2.8	-0.2
GNE	5.2	2.1	-0.5	2.3	-0.3	4.6	4.7	0.1	0.9	-0.9	2.9	-0.1
Net exports	-1.4	1.4	0.8	0.8	1.0	-2.2	-0.1	0.0	1.8	1.5	0.5	0.2
Sectors:												
Consumer Spending	3.3	2.5	0.0	2.9	-0.3	3.4	3.3	0.1	2.4	-0.2	3.1	-0.4
Dwelling Investment	-3.6	1.3	1.2	4.7	-0.6	0.7	-3.8	0.7	3.9	0.1	5.7	-0.4
Plant & equipment	10.7	-3.2	-4.6	-1.5	-3.1	15.3	2.2	-0.2	-5.9	-7.8	2.8	0.7
Software, R&D & other investment	5.0	5.1	-1.4	4.6	-0.8	5.2	4.8	-0.2	4.6	-2.2	4.6	0.0
Total Buildings and Structures	39.8	9.8	-2.7	4.4	1.5	24.7	32.2	-0.2	3.8	-2.5	0.3	1.7
New Building Construction	14.6	10.3	5.2	0.9	0.3	3.0	16.8	2.3	3.9	3.9	1.6	-1.1
New Engineering Construction	50.9	17.5	-4.5	2.0	1.8	39.8	41.3	-0.4	2.9	-4.3	-0.3	2.7
Private final demand	6.4	2.8	-0.6	2.9	-0.3	5.7	5.4	0.1	2.1	-1.1	3.0	-0.1
Government spending	1.6	0.6	0.9	0.5	0.0	-0.2	2.6	0.2	-0.9	1.1	2.0	-0.7
Inventories - contribution	-0.1	0.0	0.0	-0.1	0.0	0.3	0.0	0.0	-0.4	-0.3	0.2	0.1
Household Disposable Income	2.9	2.1	0.3	2.6	-0.8	4.5	2.2	0.1	2.2	-0.3	2.9	-0.3
Household Savings Rate	10.6	10.3	0.2	9.9	-0.2	11.0	10.3	0.1	10.1	0.0	9.9	0.1
Trade Volumes:												
Exports of goods & services	4.6	6.7	0.4	8.6	1.0	-0.7	6.0	-0.3	8.5	1.6	8.4	0.0
Imports of goods & services	11.9	0.4	-3.2	5.1	-3.3	10.9	6.4	-0.4	0.2	-5.6	7.1	-0.5
Current Account Balances:												
Trade Balance - \$bn	13.5	-0.5	4.8	1.4	11.6	27.3	-4.8	-1.5	5.4	10.6	-2.7	13.5
Net Services Balance - \$bn	-10.0	-12.3	1.5	-14.2	1.9	-8.8	-11.4	1.1	-13.0	1.7	-15.6	2.3
Net interest & dividends - \$bn	-42.6	-35.5	0.3	-36.1	1.1	-49.9	-37.4	-0.1	-34.5	1.1	-38.9	1.1
Current Account - \$bn	-40.5	-49.6	6.5	-50.2	14.6	-33.4	-55.0	-0.6	-43.4	13.3	-58.5	16.8
Current Account % GDP	-2.7	-3.3	0.4	-3.2	0.9	-2.3	-3.7	0.0	-2.8	0.8	-3.6	1.0
Terms of trade - %	0.6	-10.8	-1.2	-2.9	-2.0	12.8	-10.4	-0.1	-5.0	-2.8	-4.2	0.1
Key Other Forecasts:												
CPI - Headline	2.3	2.3	-0.2	2.3	-0.4	3.3	1.8	0.0	2.2	-0.6	2.8	0.3
CPI - 12 months to end year	1.2	2.6	-0.4	2.8	0.3	3.0	2.2	0.0	2.1	-0.7	2.8	0.2
Underlying CPI, end	2.2	2.3	0.0	2.1	0.2	2.9	2.4	0.1	1.9	0.0	2.4	0.0
Wage Cost Index	3.6	3.3	-0.1	2.9	-0.3	3.7	3.6	0.0	3.0	-0.2	3.1	-0.1
House prices	-3.2	1.8	0.8	3.5	0.3	-2.6	-0.7	0.3	2.9	0.9	4.1	-0.1
Employment	1.2	1.3	0.0	1.3	-0.5	1.8	1.1	0.1	1.4	-0.4	1.5	-0.2
Unemployment Rate (end)	5.2	5.5	0.1	5.9	0.1	5.2	5.3	0.0	5.9	0.3	5.7	0.2
Gross Operating Surplus-Companies	3.7	-5.5	-0.2	4.5	-1.4	6.6	-4.5	0.1	0.8	-1.3	5.5	-0.2
Nominal GDP	5.0	2.3	-0.4	4.5	-1.0	6.5	3.0	0.0	3.4	-1.2	5.1	-0.1
Unit Labour Costs	2.9	0.0	-1.1	0.7	-1.5	4.5	1.3	-0.1	0.0	-2.1	1.4	-0.4
Profit share	21.7	20.2	0.0	20.2	0.0	22.1	20.7	0.0	20.2	0.0	20.3	0.0

Note: * Change from previous forecasts.

Source: ABS & Citi Research

New Zealand: Q1 GDP result

GDP increased by 0.3% in Q1, lower than both the 0.5% consensus and RBNZ estimate. The yearly growth rate was 2.4%, slightly below the expected 2.5%. Our Q1 forecast was 0.4%. The closeness of the result to our estimate maintains our forecast of no rise in the OCR until Q1 2014.

The production side data was driven by the rebuild in Canterbury... The sectors that contributed the most to quarterly GDP, construction and business services were boosted by stronger activity in Canterbury. Construction (up 5.5%) gains came from increased residential building while business services (up 3.9%) was driven by engineering design and consultancy services.

...with the main offset coming from the drought. Rural activity fell 4.8% thanks to lower dairy production. The drought is likely to lead to a further fall in rural production in Q2 because of higher slaughter numbers and poorer stock conditions for cattle that will influence future lambing and calving rates.

On the expenditure side, the effects of the Canterbury rebuild were evident as well. Up by a very strong 9.6%, residential dwelling investment activity was the strongest in twelve and half years. Some of the increase in household consumption (up 0.4%) was also likely to be from the rebuild, with durables consumption up from gains in audio-visual equipment, furniture and floor coverings.

Outside of the Canterbury rebuild, growth was narrowly based. Sectors less connected to the rebuild lagged. Manufacturing, wholesale trade, transport, information and media, real estate, public administration, education, arts and recreation services were soft. While some of this is likely to be an "echo" from the solid data in Q4 2012, the volatility from quarter to quarter is not conducive to sowing the seeds of a sustained upswing in confidence among businesses. Furthermore, a big build up in inventories flattered the Q1 growth result. This was despite the rundown in agricultural output and reflects a pick-up in manufacturing, forestry and logging stocks. We suspect that inventories will drag on growth in Q2.

Implications for the RBNZ. The RBNZ would probably be pleased to see the expansion in residential investment. It is a sign that the supply side of the market is reacting to stronger demand pressures in Auckland and Canterbury. That said, overall growth is slightly below their Q1 forecast of 0.5% and is coming from a fairly narrow base. While Canterbury related reconstruction will contribute positively to activity for a number of years, the overall growth expansion will need to incorporate more sectors to add to inflation and the need for higher interest rates. The overnight decline in the exchange rate is a step in the right direction for rebalancing, but we still do not expect the RBNZ to raise the OCR until Q1 2014.

The Week Ahead

Figure 24: Key Australian & New Zealand Data and Events (AEDT)

Australia

28 June, 11:30 am

Private Sector Credit, June

Forecast: 0.3%, previous: 0.3%

The record low cash rate continues to help boost housing credit, while personal and business credits are likely to remain subdued.

Financial Market Forecasts

Figure 25. Interest rate and currency forecasts

Australia	Current	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14
Cash	2.75	2.75	2.75	2.75	3.00	3.50
90 Day Bills	2.81	2.95	3.00	3.20	3.40	3.70
3 year bond	2.79	2.70	2.80	2.90	3.20	3.75
10 year bond	3.71	3.50	3.60	3.70	4.00	4.30
3/10 spread	0.92	0.80	0.80	0.80	0.80	0.55
AU/US 10 year spread	1.27	1.10	1.00	0.90	1.00	1.15
AUD/USD	0.92	0.97	0.96	0.96	0.95	0.95
AUD/NZD	1.19	1.21	1.20	1.20	1.19	1.19
New Zealand						
	Current	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14
Cash	2.50	2.50	2.50	2.75	3.00	3.25
90 Day Bills	2.65	2.70	2.80	3.00	3.20	3.40
2 year bond	2.85	2.60	2.80	2.95	3.15	3.30
10 year bond	4.10	3.50	3.75	3.90	4.20	4.40
2/10 spread	1.25	0.90	0.95	0.95	1.05	1.10
NZ/US 10 year spread	1.66	1.10	1.15	1.10	1.20	1.25
NZ/AU 10 year spread	0.39	0.00	0.15	0.20	0.20	0.10
NZD/USD	0.78	0.80	0.80	0.80	0.80	0.80
NZD/AUD	0.84	0.82	0.83	0.83	0.84	0.84

Source: Bloomberg & Citi Research

Figure 26. Financial and Economic Calendar 17 June 2013 – 5 July 2013 (AEST)

17 United States Empire State Manufacturing, May (act 7.84%) Housing Market Index, May (act 52) Australia New Motor Vehicle Sales, May (act 0.0%)	18 United States CPI, May (act 0.1%) Housing Starts, May (act 914K) Housing Permits, May (act 974K) Australia RBA Minutes	19 United States FOMC Rate Decision, Jun (act 0.25%) New Zealand Current Account Deficit, Q1 (act \$NZ0.66bn)	20 United States Existing Home Sales, May (act 5.18m) Philly Outlook Survey, June (act 12.5%) Jobless Claims, 15 June (act 354K) China HSBC Flash Manufacturing PMI, Jun (act 49.1) New Zealand GDP, Q1 (act 0.3%)	21 New Zealand ANZ Consumer Confidence, Jun (last 3.8%)
24 United States Fed's Fisher Speaks in London	25 United States Durable Goods Orders, May (last 3.5%) New Home Sales, May (last 454K) Consumer Confidence, June (last 76.2)	26 United States GDP, 1QF (Prelim 2.4%) Chain Price Index, 1QF (Prelim 1.1%)	27 United States Personal Income, May (last 0.0%) Personal Consumption, May (last -0.2%) Fed's Powell Speaks in Washington Fed's Lockhart Speaks in Georgia China Industrial Profits YTD YoY, May (last 11.4%) New Zealand Trade Balance, May (last \$NZ157m)	28 United States Chicago Barometer, June (last 58.7) UoFM Sentiment, June(F) (Prelim 82.7) Fed's Lacker Speaks in West Virginia Fed's Williams Speaks in CA Australia Private Sector Credit, May (f/c 0.3%) New Zealand Building Permits, May (last 18.5%)
1 United States ISM Manufacturing PMI, Jun (last 49.0) Construction PIP, May (last 0.4%) China Manufacturing PMI, Jun (last 50.8) Australia RBA Commodity Price Index, Jun (last -8.6%)	2 United States Factory Orders, May (last 1.0%) Total Vehicle Sales, Jun (last 15.2m) Australia RBA Cash Rate, Jul (last 2.75%)	3 United States ADP Employment, Jun (last 135K) Jobless Claims Trade Balance, May (last -\$40.3bn) ISM Non-Manufacturing PMI, Jun (last 53.7) China Non-Manufacturing PMI, Jun (last 54.3) Australia Trade Balance, May (last 28m) Retail Sales, May (last 0.2%) RBA Governor's speech to Economic Society of Australia, Brisbane	4 United States Public Holiday Australia Building Approvals, May (last 9.1%) RBA Deputy Governor's speech to Global Financial Stability Conference, Sydney	5 United States Payrolls, Jun (last 175K) Unemployment Rate, Jun (last 7.6%) Avg. Hrly. Earn., Jun (last 0.0%)

Source: Bloomberg, Reuters and Citi Research. A = Advance P = Preliminary. R = Revised S = Second Release T = Third Release F = Final.

Note: All data are month-to-month (quarter-to-quarter) percentage changes, unless otherwise stated.

Appendix A-1

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